In The

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

NO. 412

FRED W. WOODWARD and ELSIE M. WOODWARD,
F. R. WOODWARD and M. JEANNE WOODWARD,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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The minutes of a special meeting of the common stock shareholders of the Telegraph-Herald, held on June 9, 1960, containing a Resolution duly adopted, pursuant to the statutory procedural requirements of Section 491.25 of the 1958 Code of Iowa, by a majority of all of the issued and outstanding common stock of the said corporation, renewing and extending its corporate existence perpetually 9

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The Petition in Equity filed, pursuant to Section 491.25 of the 1958 Code of Iowa, by the majority (affirmative voting) shareholders of the Telegraph-Herald, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased, on February 9, 1962, in the District Court of Iowa in and for Dubuque County, asking such Court to determine and fix the real value of the dissenting shareholder's common stock of the Telegraph-Herald 15

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Fred W. Woodward and Elsie M. Woodward,
F. R. Woodward and M. Jeanne Woodward
Petitioners

v

Commissioner of Internal Revenue
Respondent

RELEVANT DOCKET ENTRIES

Date	Filings—Proceedings
July 22, 1968	Certified Transcript of Proceedings before the Tax Court of the United States, filed; cause Docketed.
March 11, 1969	Cause argued to Judges Matthes, Mehaffy and Lay; cause submitted.
May 2, 1969	Opinion by Judge Matthes, filed.
	Judgment of Court: Decision of the Tax Court of the United States affirmed; and, Petition to Review dismissed.
May 26, 1969	Mandate issued.

STIPULATION OF FACTS IN THE TAX COURT OF THE UNITED STATES—FILED JULY 22, 1968

It is hereby stipulated that, for the purpose of these cases, the following statements may be accepted as facts and all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part

hereof; subject to the right of any party to object to the admission of such facts in evidence on the grounds of materiality and relevancy; provided, however, that any party may introduce other and further evidence not inconsistent with the facts herein stipulated.

1. Petitioners, Fred W. Woodward and Elsie M. Woodward, are husband and wife and reside at 1090 West 3rd Street, Dubuque, Iowa. They filed a joint federal income tax return for the taxable year 1963 with the District Director of Internal Revenue at Des Moines, Iowa. A copy of said return is attached hereto and marked Exhibit A.

2. Petitioners, F. R. Woodward and M. Jeanne Woodward, are husband and wife and reside at 384 Wartburg Place, Dubuque, Iowa. They filed a joint federal income tax return for the taxable year 1963 with the District Director of Internal Revenue at Des Moines, Iowa. A copy of said return is attached hereto and marked Exhibit B.

3. Petitioners, F. R. Woodward and M. Jeanne Woodward, are the son and daughter-in-law, respectively, of petitioners, Fred W. Woodward and Elsie M. Woodward.

4. The Telegraph-Herald is a profit corporation organized under the laws of the State of Iowa. Said corporation is engaged in publishing a daily newspaper, operating a commercial printing plant and operating a radio station in Dubuque, Iowa.

5. On June 9, 1960, the Telegraph-Herald had 1200 shares of common stock issued and outstanding. Ownership of said shares on that date was as follows:

Common Stockholder	Number of Shares
Fred W. Woodward	398
F. R. Woodward	58
M. Jeanne Woodward	55
Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank of Dubuque, Iowa, as Trustees of Fred W. Woodward Trust No. 1	200
Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank of Dubuque, Iowa, as Trustees of Fred W. Woodward Trust No. 2	100
Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased	10
Margaret M. Quigley	379
Total	1,200

6. The Telegraph-Herald was originally incorporated in 1901. Its corporate existence was renewed in 1921 and 1941, and under the 1941 renewal its corporate existence was extended 20 years to November 1, 1961. The common stockholders of the Telegraph-Herald held a special meeting on June 9, 1960, for the purpose of renewing and extending its corporate existence and to consider placing certain restrictions on its common stock.

7. At the special stockholders' meeting on June 9, 1960, which was attended by all of the common stockholders or their representatives, a resolution was duly adopted by a majority of all the stockholders extending the Telegraph-Herald's corporate existence perpetually. A copy of the minutes of said special meeting is attached hereto and marked Exhibit 1.

8. A certificate for the renewal of the Telegraph-Herald's corporate charter was issued by the Secretary of State for the State of Iowa, on or about June 10, 1960.

9. Of the Telegraph-Herald's 1200 shares of common stock issued and outstanding all voted in favor of the renewal of the corporate existence except the 379 shares owned by Margaret M. Quigley.

10. Section 491.25 of the Iowa Code Annotated provides as follows:

"491.25 Renewal—procedure

'Corporations existing for a period of years may be renewed from time to time for the same or shorter periods, or may be renewed to exist perpetually, upon compliance with the provisions of this section and other applicable statutes.

'The right of renewal is vested in the stockholders and shall be exercised by a resolution thereof adopted at any regular meeting or at any special meeting called for that purpose. Such resolution must be adopted by a majority of all the votes cast at such meeting, or by such other vote as is authorized or required in the company's existing articles of incorporation.

'If the renewal instrument in proper form and the necessary fees are tendered to the secretary of state for filing three months or less either prior or subsequent to the corporation's expiration date, such renewal shall take effect immediately upon the expiration of the corporation's previous period of existence, and in such case, the corporate existence shall be considered as having been extended without interruption. If the renewal is filed more than three months before or after the expiration date, such renewal shall take effect upon the date such renewal with neces-

sary fees is accepted and filed by the secretary of state; and in cases where filed more than three months after the expiration date, shall not be in legal effect a renewal unless the procedure provided for and the additional fees provided for in section 491.28 are fully complied with and paid.

'In all cases of renewal, those stockholders voting for such renewal must purchase at its real value the stock voted against such renewal, and shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal, which purchase price shall bear interest at the rate of five percent per annum from the date of such renewal action until paid. As amended, Acts 1955 (56 G. A.), ch. 229, § 1."

11. The majority stockholders voting to extend the corporate existence of the Telegraph-Herald and Margaret M. Quigley were unable to agree upon the real value of the latter's stock. The majority stockholders, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased, on February 9, 1962, filed a Petition in Equity in the District Court of Iowa, in and for Dubuque County, asking the Court to determine and fix the real value of Margaret M. Quigley's stock; a copy of such petition is attached hereto and marked Exhibit 2. The decision entered by the District Court establishing a value of $1,750 per share was appealed by all parties to the Supreme Court of Iowa. A copy of the District Court's Findings of Fact, Conclusions of Law and Decree Fixing "Real Value" is attached hereto and marked Exhibit 3.

12. In the case of **Woodward v. Quigley**, 133 N. W. 2d 38 (Iowa 1965), the Supreme Court of Iowa determined the real value of Margaret M. Quigley's shares to be $1,650 per share. On rehearing the Supreme Court of

Iowa in **Woodward v. Quigley**, 136 N. W. 2d 280 (Iowa 1965), redetermined the real value of Margaret M. Quigley's stock in the Telegraph-Herald to be $1,620 per share. Both of said opinions of the Supreme Court of Iowa are, by this reference thereto, made a part of this stipulation as if fully set forth herein.

13. Subsequent to the entry of final judgment in **Woodward v. Quigley**, *supra*, the 379 shares of Telegraph-Herald stock owned by Margaret M. Quigley were purchased on July 16, 1965, by the majority stockholders voting to extend the corporate existence of the Telegraph-Herald as follows:

Purchaser	Number of Shares Purchased
F. W. Woodward	184
F. R. Woodward	27
M. Jeanne Woodward	25
Trust No. 1	92
Trust No. 2	46
Estate of Ellen Murphy	5
Total	379

14. During the taxable year 1963 the majority stockholders voting to extend the corporate existence of the Telegraph-Herald, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased, paid attorneys', accountants', and appraisers' fees, costs and disbursements in the total amount of $37,890.75 for services rendered in connection with the determination of the real value of Margaret M. Quigley's stock as follows:

Description of Expenses	Amount of Payment
Clewell, Cooney & Fuerste (Attorneys' Fees)	$17,224.14
American Appraisal Company	8,684.40
Ernst & Ernst (Accounting Fees)	5,485.00
Reporting Services	4,635.76
Miscellaneous	1,861.45
Total	$37,890.75

15. The proportionate share of the fees, costs and disbursements, referred to in paragraph 14, above, paid by petitioner, Fred W. Woodward, during the taxable year 1963 was $20,072.23.

16. The proportionate share of the fees, costs and disbursements, referred to in paragraph 14, above, paid by petitioners, F. R. Woodward and M. Jeanne Woodward, during the taxable year 1963 was $5,931.51.

17. Petitioners, Fred W. Woodward and Elsie M. Woodward, claimed the $20,072.23 anount, referred to in paragraph 15, above, as an itemized deduction under "Other Deductions" on their federal income tax return for the taxable year 1963 (Exhibit A).

18. Petitioners, F. R. Woodward and M. Jeanne Woodward, claimed the $5,931.51 anount, referred to in paragraph 16, above, as an itemized deduction under "Other Deductions" on their federal income tax return for the taxable year 1963 (Exhibit B)

19. Respondent concedes that the fees, costs and disbursements, paid by Petitioners as set forth in paragraphs 15 and 16, above, were reasonable in amount and with the exceptions of $185.00 and $85.00 noted in paragraphs 20 and 21 hereof, respectively, were incurred in connection with the determination of the real value of Margaret M. Quigley's shares of stock in the Telegraph-Herald.

20. The respondent concedes that $185.00 of the $20,072.23 deduction for professional fees, disallowed in adjustment (a) on page 1 of the statement attached to the statutory notice of deficiency (Docket No. 4363-65), is an allowable deduction because said $185.00 was paid for professional services rendered in the preparation of a gift tax return and federal and state income tax returns for the taxable year 1962.

21. The respondent concedes that $85.00 of the $5,931.51 deduction for professional fees, disallowed in adjustment (a) on page 1 of the statement attached to the statutory notice of deficiency (Docket No. 4364-65), is an allowable deduction because said $85.00 was paid for professional services rendered in the preparation of petitioners' federal and state income tax returns for the taxable year 1962.

22. If respondent's determination in Docket No. 4363-65 is not sustained by the Court, the respondent concedes that petitioners therein were not required to include the $3,600.00 received by Elsie M. Woodward from the Fred W. Woodward Trust No. 1 as income in their federal income tax return for the taxable year 1963.

23. Petitioners, Fred W. Woodward and Elsie M. Woodward filed a claim for refund for overpayment of their income tax for taxable year 1963 in the amount of $1,134.47 with the District Director of Internal Revenue for the District of Iowa on July 19, 1965.

Donald P. Cooney
Counsel for Petitioners

Lester R. Uretz
Chief Counsel, Internal Revenue Service

PETITIONERS' EXHIBIT 1

Special Meeting of the Stockholders of Telegraph-Herald

June 9, 1960

A special meeting of stockholders of Telegraph-Herald was held at the office of the Company, 8th Avenue and Bluff Street, Dubuque, Iowa, on June 9, 1960, at 10:00 o'clock A. M. pursuant to the following notice:

To the Holders of Capital Stock of Telegraph-Herald:

Notice Is Hereby given that by direction of the President a special meeting of the stockholders of Telegraph-Herald will be held at the office of the Company, West 8th and Bluff Streets in the City of Dubuque, Iowa, on Thursday, June 9, 1960 at 10:00 o'clock A. M. for the purpose of considering and acting upon amending the Amended, Substituted and Renewal Articles of Incorporation of said corporation in the following respects:

1. By amending Article I of said Articles of Incorporation in such manner as to strike out the date of November 1, 1961 for the expiration of its corporate period and substitute in lieu thereof a provision giving the corporation perpetual existence.

2. By amending Article IV of said Articles of Incorporation by adding thereto the following provision:

> "Before any stock may be sold and transferred on the books of the corporation, the owner of such stock shall give notice in writing to the Secretary stating the number of shares proposed to be sold, the person or persons to whom and the price at which it is proposed to sell the same. The corporation, by appropriate action of the Board of Directors, shall have the right to purchase said

stock at the price so stated, and if the corporation does not purchase said stock the same shall be offered for sale to the other shareholders in the proportion of their current holdings. If neither the corporation nor the shareholders elect to purchase said stock within thirty days from the date on which the Secretary receives notice of intention to sell as above set out, then the owner of said stock shall have the right to sell the same to the person or persons and at the price so stated in the notice."

Dubuque, Iowa, May 24, 1960.

F. R. Woodward
Secretary

The following were present at the meeting: F. W. Woodward, F. R. Woodward, Elsie M. Woodward, M. Jeanne Woodward, Margaret Quigley, Charles J. Murphy, executor of the estate of Ellen Murphy, deceased, Tharsella Pins and Attorneys F. J. O'Connor, E. Marshall Thomas and Robert W. Clewell.

It was moved and seconded that F. W. Woodward act as Chairman of the meeting and F. R. Woodward act as Secretary. Motion carried.

At the request of Mr. O'Connor the names of the stockholders and the number of shares in the name of each stockholder were read as follows:

F. W. Woodward	398	shares
Fred W. Woodward Trust No. 1	200	"
Fred W. Woodward Trust No. 2	100	"
Margaret Quigley	379	"
Ellen Murphy (Charles J. Murphy, executor)	10	"
F. R. Woodward	58	"
M. Jeanne Woodward	55	"
Total	1200	"

The Secretary reported that all of the outstanding shares of stock were represented at the meeting in person.

Referring to the proposed amendments mentioned in the call of the meeting, Mr. Clewell commented on the advantages to a corporation of a provision giving it and the stockholders the first opportunity of purchasing any stock proposed to be sold and transferred on the books of the corporation, stating that such a provision is in quite general use and is regarded as a safeguard against the distribution of shares to those of a succeeding generation and others not closely associated in the Company. Referring to the proposed amendment providing for perpetual existence, he called attention to the fact that the present corporate period will expire November 1, 1961, at or prior to which time it seems likely that the corporation will elect to adopt the provisions of the new Iowa Business Corporation Act which, among other advantages, authorizes perpetual duration.

At the direction of the Chairman the following resolution which had been prepared for submission to the meeting, was read:

Resolution.

Resolved by the stockholders of Telegraph-Herald that Article I of the Renewal, Amended and Substituted Articles of Incorporation of this corporation is amended by striking out all of said Article I and substituting in lieu thereof the following:

"Article I.

The name of this corporation is Telegraph-Herald and its office and principal place of business is in the City of Dubuque, in Dubuque County, State of Iowa. It commenced business under its original articles of incorporation on the 1st day of November, 1901. Its corporate period has been renewed from

time to time and by amendment adopted at a special meeting of stockholders held on June 9, 1960, this corporation shall have perpetual existence from and after the date on which the certificate of said amendment is issued by the Secretary of State of the State of Iowa. This corporation may be dissolved by a vote of the holders of not less than three-fourths of the total number of shares of stock issued and outstanding."

and

Resolved Further that Article XII of the Renewal, Amended and Substituted Articles of Incorporation of this corporation is amended by adding thereto the following:

"Before any stock may be sold and transferred on the books of the corporation, the owner of such stock shall give notice in writing to the Secretary stating the number of shares proposed to be sold, the person or persons to whom and the price at which it is proposed to sell the same. The corporation, by appropriate action of the Board of Directors, shall have the right to purchase said stock at the price so stated, and if the corporation does not purchase said stock the same shall be offered for sale to the other shareholders in the proportion of their current holdings. If neither the corporation nor the shareholders elect to purchase said stock within thirty days from the date on which the Secretary receives notice of intention to sell as above set out, then the owner of said stock shall have the right to sell the same to the person or persons and at the price so stated in the notice."

Resolved Further that the President and Secretary of this corporation are designated as the officers to sign and acknowledge said Amendments to Renewal,

Amended and Substituted Articles of Incorporation and a suitable certificate thereof, to file and record the same, to publish notice thereof and to take such other steps and to do such other acts and things as deemed advisable in the premises.

A motion to adopt the resolution was made and seconded.

A discussion followed.

Mr. O'Connor requested that detailed financial statements be furnished to his client Margaret Quigley. The Chairman replied that copies of the auditor's reports are available and may be obtained by the stockholders but that the financial statements in detail have never been permitted to leave the office or even be available for inspection by employees in the office. In behalf of Margaret Quigley an exception and objection was noted to the refusal of the officers to furnish such detailed statements. The officers explained, however, that any stockholder, either personally or by attorney or agent, would be afforded an opportunity to examine the books and records and make copies of such portions as they desired with the admonition that any circulation of same would be extremely detrimental to the best interests of the corporation.

Mr. O'Connor then inquired about the expansion program and its probable cost. Mr. F. R. Woodward stated that the estimate was around a million dollars and of that amount the proposed new press, which would be the costliest item, would run around $600,000.00. He said that the Company wishes to avoid the necessity of borrowing to any greater extent than necessary, that up to now around $300,000.00 has been saved for the program and by waiting a few years longer a large indebtedness and a very considerable amount of interest will be avoided. Mr. O'Connor then requested information as to the compensation paid the President and Secretary. The Chair-

man requested Miss Pins to obtain the figures from Mr. Kane. Upon returning she had the figures and it was agreed that the salaries were quite moderate.

Mr. Murphy spoke to Mr. Clewell about the procedure and indicated that in his opinion a minority stockholder would be better protected if the articles were renewed for a definite number of years. There being no further discussion a vote was taken upon the motion to adopt the resolution and upon roll call the vote was as follows:

F. W. Woodward .....Yes
Fred W. Woodward Trust No. 1 (voted by F. R. Woodward, Trustee) .....Yes
Fred W. Woodward Trust No. 2 (voted by F. R. Woodward, Trustee) .....Yes
Margaret Quigley .....No

Before voting the Ellen Murphy stock, Charles J. Murphy requested an additional explanation as to what the effect would be if he voted "yes" or voted "no" on the motion. Mr. Clewell advised him that the corporation shall have perpetual existence if the resolution is adopted by a majority vote in which case the stockholders voting for the same must purchase at its real value the stock voted against the resolution and shall have three years in which to purchase and pay for the stock with interest at the rate of 5% per annum. Thereupon Mr. Murphy voted .....Yes
F. R. Woodward .....Yes
M. Jeanne Woodward .....Yes

Thereupon the Chairman declared the resolution adopted by a majority of all the votes cast at the meeting.

Mr. Murphy then stated that he was still of the opinion that a renewal for a shorter duration would be better. Mr. Clewell advised him that having voted in the affirma-

tive he is in the parliamentary position to move to reconsider the action taken. Mr. Murphy moved to reconsider the action upon the resolution but the motion failed for want of a second.

There being no further business, the meeting adjourned.

F. R. Woodward
Secretary

PETITIONERS' EXHIBIT 2

In the District Court of Iowa in and for Dubuque County

F. W. Woodward, F. R. Woodward, M. Jeanne Woodward; and Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank, Dubuque, Iowa, Trustees of Fred W. Woodward Trust No. 1; and Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank, Dubuque, Iowa, Trustees of Fred W. Woodward Trust No. 2,

Plaintiffs,

vs.

Margaret M. Quigley,

Defendant.

No. 80,257

Petition in Equity

Plaintiffs state:

Par. 1. That the Plaintiffs, F. W. Woodward, F. R. Woodward and M. Jeanne Woodward, are the owners of

capital stock of Telegraph-Herald, an Iowa corporation, with its principal place of business in the City of Dubuque, Dubuque County, Iowa, that the Plaintiffs, Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank, Dubuque, Iowa, an Iowa corporation, as Trustees of the Fred W. Woodward Trust No. 1, are the owners of capital stock of said corporation; that the Plaintiffs, Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank, Dubuque, Iowa, an Iowa corporation, as Trustees of the Fred W. Woodward Trust No. 2, are the owners of capital stock of said corporation.

That each and all of said Plaintiffs are residents of Dubuque County, Iowa.

Par. 2. That the Defendant Margaret M. Quigley is a resident of Dubuque County, Iowa, and an owner of capital stock in said corporation.

Par. 3. That as of June 9, 1960, the Plaintiffs and the Defendant were the owners of all of the outstanding capital stock of said corporation except for ten shares owned by the Estate of Ellen E. Murphy, deceased, of which Charles J. Murphy was the duly appointed, qualified and acting Executor.

Par. 4. That a special meeting of the stockholders of the corporation was held at its office in the City of Dubuque, Iowa, on June 9, 1960 at 10:00 o'clock A. M., due notice of which meeting had been given to all holders of capital stock of the corporation.

That all of the capital stockholders were present or represented at said meeting.

Par. 5. At said special meeting of the stockholders of said corporation a resolution was duly adopted by a vote

of the majority of all of the outstanding capital stock of said corporation, renewing and extending perpetually its corporate existence.

Par. 6. That all of the capital stockholders except the Defendant voted to renew the Articles of Incorporation and the Defendant voted against renewal.

Par. 7. That Section 491.25 of the 1958 Code of Iowa provides as follows:

> "In all cases of renewal, those stockholders voting for such renewal must purchase at its real value the stock voted against such renewal, and shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal, which purchase price shall bear interest at the rate of five percent per annum from the date of such renewal action until paid."

Par. 8. That the Plaintiffs and Defendant have been unable to agree as to the real value of the Defendant's stock as of June 9, 1960, the day the renewal resolution was adopted.

Wherefore, Plaintiffs ask that the Court determine and fix the real value of the Defendant's Telegraph-Herald capital stock as of June 9, 1960, for costs and for such other and further relief as shall be just and equitable.

Robt. W. Clewell and
M. M. Cooney
Members of the Firm of
Clewell, Cooney & Fuerste
705 Roshek Building
Dubuque, Iowa
Attorneys for Plaintiffs

PETITIONERS' EXHIBIT 3

In the District Court of Iowa in and for Dubuque County

F. W. Woodward et al.
vs.
Margaret M. Quigley.
} Equity No. 80257.

Findings of Fact, Conclusions of Law and Decree Fixing "Real Value"

This case came on for trial on September 17th, 1962, the plaintiffs appearing by M. M. Cooney and Donald Cooney of the firm of Clewell, Cooney & Fuerste, and the defendant appearing by Francis J. O'Connor and E. Marshall Thomas of the firm of O'Connor, Thomas, McDermott & Wright, and the submission of evidence was completed on the 26th day of October 1962. Counsel having filed written briefs and arguments and the Court having heard oral arguments of counsel on April 30th and May 1st, 1963, and the Court now being fully advised hereby makes the following Findings of Fact, Conclusions of Law and Decree Fixing the "Real Value" of defendant's stock of Telegraph-Herald as of June 9, 1960, as follows:

Findings of Fact

1. Telegraph-Herald is an Iowa profit corporation and was originally incorporated in 1901. Its corporate existence was renewed in 1921 and 1941, and under the 1941 renewal its corporate existence was extended 20 years to November 1, 1961.

2. On June 9, 1960, the outstanding capital stock of Telegraph-Herald consisted of 1,200 shares of $100 par value common stock, which stock was owned by the following persons:

F. W. Woodward .....398 Shares
F. R. Woodward ..... 58 Shares
M. Jeanne Woodward ..... 55 Shares
Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward, and American Trust & Savings Bank, Dubuque, Iowa, Trustees of Fred W. Woodward Trust No. 1 .....200 Shares
Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank, Dubuque, Iowa, Trustees of Woodward Trust No. 2 ....100 Shares
Ellen Murphy, deceased, Charles J. Murphy, Executor ..... 10 Shares
Margaret M. Quigley, defendant .....379 Shares

3. At a special meeting of the stockholders of Telegraph-Herald, held on June 9, 1960, the Articles of Incorporation of Telegraph-Herald were amended to provide, among other matters, perpetual existence for said corporation. All of the outstanding stock of Telegraph-Herald was represented at such meeting in person or by proxy and was voted in favor of said amendments, except the 379 shares, owned by the defendant, Margaret M. Quigley, which were voted against the renewal of corporate existence.

4. On June 9, 1960, and for many years prior thereto, Telegraph-Herald owned and published the "Telegraph-Herald," a daily newspaper, published six days a week, Monday through Friday and on Sunday, and owned and operated radio station KDTH in Dubuque, Iowa, operating on AM frequency with 1 kilowatt power. On June 9, 1960, the Telegraph-Herald corporation was also the owner of all the outstanding common stock, consisting of 100 shares of $100 par value, of Visual Education Center, Inc., which was engaged in selling educational filmstrips and other educational material for publication in newspapers.

5. The plaintiffs are the persons listed in Findings of Fact No. 2, except the owners of the Murphy stock and the defendant, Margaret M. Quigley.

6. Plaintiff F. W. Woodward is and was at all times relevant hereto the President and Publisher of Telegraph-Herald. Plaintiff F. R. Woodward is the son of F. W. Woodward and is and was at all times relevant hereto the Secretary and Treasurer and General Manager of Telegraph-Herald. Plaintiff M. Jeanne Woodward is the wife of F. R. Woodward and plaintiff Elsie M. Woodward is the wife of F. W. Woodward. M. R. Kane is and was at all times relevant hereto the Vice President of Telegraph-Herald.

7. The Board of Directors of Telegraph-Herald in 1960 and for many years prior thereto was as follows: F. W. Woodward, F. R. Woodward, M. Jeanne Woodward, Elsie M. Woodward and M. R. Kane.

8. The defendant Margaret M. Quigley has never been an officer or director of Telegraph-Herald.

9. Margaret M. Quigley acquired her 379 shares of stock of Telegraph-Herald by bequest from her husband, Joseph C. Quigley, who died January 22, 1952.

10. On June 9, 1960, and for many years prior thereto the Telegraph-Herald newspaper was the only daily newspaper published in the City of Dubuque, or in the County of Dubuque, Iowa.

• • • • • • • •

33. The common capital stock of the Telegraph-Herald has not been sold or offered for sale nor have any bids been made to purchase said stock during the years 1950 to June 9, 1960.

• • • • • • • •

Conclusions of Law

1. The Court has jurisdiction of the parties and the subject matter hereof.

2. This is an equitable proceeding to fix and determine the real value of defendant's 379 shares of stock in the Telegraph-Herald corporation as of June 9, 1960, under section 491.25 Code of Iowa, said stock having been voted against renewal of the corporate charter on said date.

3. That plaintiffs (together with owner of 10 shares of Murphy stock) voted for the renewal of the corporate charter of Telegraph-Herald on June 9, 1960 and have the obligation to purchase defendant's 379 shares of stock of Telegraph-Herald at its "real value" under Section 491.25 Code of Iowa plus interest thereon at the rate of 5% per annum from June 9, 1960 until paid.

4. "Real Value" as used in Section 491.25 of the Code of Iowa, does not mean market value of the minority interest.

Robbins v. Beatty, 246 Iowa 80, 67 N. W. 2d 12 (1954).

Note: The authorities in other jurisdictions generally agree that the terms "value," "actual value," "true," "fair" or "real" value of minority stock in merger or consolidation cases do not mean market value of the minority interest.

Tri-Continental Corp. v. Battye, Del. Ch. 74 A. (2d) 71;

American General Corporation v. Camp, 171 Md. 629;

In Re Fulton, 257 N. Y. 487, 178 N. E. 766 (1921);

Petry v. Harwood Electric Co., 280 Pa. 142, 124 Atl. 302 (1924);

Republic Finance & Investment Company v. Fenstermaker, 211 Ind. 251, 6 N. E. (2d) 541 (1937);

Roessler v. Security Savings & Loan Co., 72 N. E. (2d) 259 (1947).

5. "Real Value" as used in Section 492.25 of the Code of Iowa, means intrinsic value, determined from a consideration of every relevant factor bearing upon the question of value.

6. In determining real value under Section 491.25, Code of Iowa, no reduction should be made on account of brokerage fees, flotation costs, or lack of marketability.

7. The real value of the 379 shares of stock of the Telegraph-Herald owned by defendant Margaret M. Quigley as of June 9, 1960, was $1,750.00 per share, or a total of $663,250.00.

8. The costs of this case are taxed to the parties as follows: 68% to plaintiffs and 32% to defendant.

Decree

It is, therefore, Ordered, Adjudged and Decreed that the "real value" of the 379 shares of common capital stock of Telegraph-Herald owned by the defendant, Margaret M. Quigley as of June 9, 1960, was $1,750.00 per share, or a total of $663,250.00 and the costs are taxed herein as follows: 68% to plaintiffs and 32% to the defendant.

Dated this 18th day of May, 1963.

By the Court:

Eugene J. Kean
Judge
XIXth Judicial District of Iowa

OPINION

In the
Supreme Court of Iowa

No. 51390

Woodward, et al. v. Quigley

February 9, 1965

(133 N. W. 2d 38)

At page 39 of 133 N. W. 2d, the Court speaking through Justice Stuart, stated as follows, to-wit:

"The corporate life of the Telegraph-Herald, a newspaper in Dubuque, Iowa, was due to expire December 31, 1961. At a special stockholders' meeting on June 9, 1960, a resolution was duly adopted by a majority of all the stockholders extending the corporate existence perpetually. Of the 1200 shares of stock outstanding all voted in favor of the renewal except the 379 shares owned by defendant. Section 491.25 of the Code, I. C. A., provides in part:

'In all cases of renewal, those stockholders voting for such renewal must purchase at its real value the stock voted against such renewal, and shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal, which purchase price shall bear interest at the rate of five percent per annum from the date of such renewal action until paid.'

Plaintiffs recognized their obligation to purchase the stock under this statute, but the parties have been unable to agree on the 'real value' of defendant's stock. This action was brought by the majority stockholders to secure a court determination of its 'real value'. The trial court established a value of $1,750 per share and both parties have appealed."

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The Court, at page 42 of 133 N. W. 2d enunciated the object or standard inherent in the appraisal statute; to-wit:

"Our 'real object is to ascertain the actual worth of that which the dissenter loses because of his unwillingness to go along with the controlling stockholders, that is, to indemnify him'. Warren v. Baltimore Transit Company, 220 Md. 478, 154 A. 2d 796."

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The Court traced the legislative history of the appraisal statute as follows on page 42 of 133 N. W. 2d; to-wit:

"Before turning to a discussion of the investment value of defendant's stock, we must dispose of two propositions urged by plaintiffs which directly affect its real value. Plaintiffs' valuation witnesses arrived at the real value of defendant's stock by giving an opinion as to the value of the stock in the corporation per share and then discounting that value (1) for a broker's commission and (2) because defendant's share represented a minority interest. Plaintiffs argue that these are 'relevant factors' to be considered in determining the real value or intrinsic worth of defendant's share in the corporation. We do not agree with this argument.

Defendant's stock is to be valued as in a 'going concern'. Plaintiffs have repeatedly urged this proposition.

We believe their arguments on these two propositions are a departure from that principle. These factors would be present only in the event of a sale of stock and would therefore be more likely to affect market value of the stock than investment value. There is no reason to consider either of these factors here. It was necessary to consider liquidation value of the assets to protect the minority from an arbitrary action by the majority. In these instances there are no brokerage commissions to be paid in fact and the majority will not be subject to the handicaps of a minority stockholder by such a purchase.

We also believe that consideration of such factors would negative one of the main purposes of section 491.25. The original statute was similar to those enacted in most states to modify the common law rule which required unanimous consent of all the stockholders for a substantial change in the corporate structure. The increase in the number of corporations and stockholders made such a rule impracticable. The statute was enacted to permit a majority to vote to renew the corporate life and at the same time allow a dissenting minority to get out of the corporation with the "real value" of its stock. It prevented the minority from being squeezed out for a lesser price.

The U. S. Supreme Court discussed this type of statute in Voeller v Neilston Warehouse Co., 311 U. S. 531, 61 S. Ct. 376, 85 L. Ed. 322, and in speaking through Justice Black said:

"At common law, unanimous shareholder consent was a prerequisite to fundamental changes in the corporation. This made it possible for an arbitrary minority to establish a nuisance value for its shares by refusal to cooperate. To meet the situation, legislatures authorized the making of changes by a majority vote. This, however, opened the

door to victimization of the minority. To solve the dilemma, statutes permitting a dissenting minority to recover the appraised value of its shares, were widely adopted."

In Iowa prior to 1933, the statute as then worded and interpreted required the majority to purchase the dissenter's stock as a condition precedent to the issuance of a certificate of corporate renewal. In those instances where the majority was unable to finance the purchase of the minority stock, the minority was in a position to force a liquidation against the will of the majority.

In 1933, the 45th General Assembly attempted to correct this injustice by adding the following sentence:

"Stockholders voting for renewal shall have three years from the date such action for renewal was taken in which to purchase the stock voted against such renewal, which purchase price shall bear interest at eight (now five) percent per annum from the date of such renewal action until paid, * * *."

In State ex rel. Robbins v. Shellsburg Grain & Lumber Co., 243 Iowa 734, 739, 53 N. W. 2d 143, 145, we discuss this historical development saying:

"It is true * * * the object of the purchase clause in the statute is to protect a minority stockholder against roughshod tactics upon the part of a majority group." We conclude that the 1933 amendment "was enacted to protect the majority group in voting for a renewal of the corporate charter. It gave to them a three-year period of grace within which to arrange for payment of the real value of the dissenter's stock, without being harassed by judgments and executions." We do not here have a question of the issuance of a certificate of renewal or harassment by judgment or executions. We are concerned with the real value of defendant's stock and the amend-

ment did not change the basic purposes of the statute. The majority was given the right to continue the corporation in return for the payment to the minority of its fair share of the real value of the corporation. It is contrary to the purpose of the statute to discount the minority interest because it is a minority. This in effect would let the majority force the minority out without paying it its fair share of the value of the corporation.

No cases have been cited which say outright that there should be no discount because a minority interest is involved. Our attention, however, has been directed to several cases which seem to so hold, in effect. In American General Corporation v. Camp, 171 Md. 629, 190 A. 225, the Maryland court stated that the dissenting stockholder was entitled to receive "the aliquot proportion which the number of shares held would be entitled to receive in the distribution of the net amount of the corporate funds in which his particular kind of stock would be entitled to share."

In Tri-Continental Corporation v. Battye, 31 Del. Ch. 523, 74 A. 2d 71, the Delaware Court said:

"The basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern. * * * The ultimate value of General's common stock, therefore, is the percentage of the fair asset value which could reasonably be expected, at some time, to have been realized by the common stockholder."

OPINION
of the
Tax Court of the United States

No. 4363-65

No. 4364-65

Fred W. Woodward and Elsie M. Woodward
Petitioners

v.

Commissioner of Internal Revenue
Respondent

F. R. Woodward and M. Jeanne Woodward
Petitioners

v.

Commissioner of Internal Revenue
Respondent

January 23, 1968

Tietjens, Judge: These consolidated cases involve deficiencies determined by respondent for the calendar year 1963 as follows:

Docket No.	Petitioners	Deficiency
4363-65	Fred W. Woodward and Elsie M. Woodward	$9,433.29
4364-65	F. R. Woodward and M. Jeanne Woodward	3,122.59

The sole issue for decision is whether fees and costs paid in connection with litigation to determine the value of certain stock represented capital expenditures or deductible expenses. In docket No. 4363-65 petitioners claim an overpayment of $1,134.47. Certain concessions of the respondent may be given effect under Rule 50.

All the facts are stipulated and are so found.

Petitioners Fred W. Woodward and Elsie M. Woodward are husband and wife. Petitioners F. R. Woodward and M. Jeanne Woodward are husband and wife. F. R. Woodward is a son of Fred W. and Elsie M. Woodward. All of the petitioners are residents of Dubuque, Iowa. Each couple filed a joint Federal income tax return for the calendar year 1963 with the district director of internal revenue at Des Moines, Iowa.

The Telegraph-Herald is a profit corporation organized under the laws of the State of Iowa, and is engaged in publishing a daily newspaper, operating a commerical printing plant and a radio station in Dubuque.

On June 9, 1960, the Telegraph-Herald had 1,200 shares of common stock issued and outstanding. Ownership of such shares on that date was as follows:

Owner	Number of Shares
Fred M. Woodward	398
F. R. Woodward	58
M. Jeanne Woodward	55
Elsie M. Woodward, R. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank of Dubuque, Iowa, as Trustees of Fred W. Woodward Trust No. 1	200
Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank of Dubuque, Iowa, as Trustees of Fred W. Woodward Trust No. 2	100
Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased	10
Margaret M. Quigley	379
Total	1,200

The Telegraph-Herald was originally incorporated in 1901. Its corporate existence was renewed in 1921 and 1941. Under the 1941 renewal its corporate existence was extended 20 years to November 1, 1961. The common stockholders of the Telegraph-Herald held a special meeting on June 9, 1960, for the purpose of renewing and extending its corporate existence and to consider placing certain restrictions on its common stock. This meeting was attended by all of the stockholders or their representatives, at which time a resolution was duly adopted by the holders of a majority of the stock extending the corporate existence of Telegraph-Herald perpetually.

A certificate of the renewal of the Telegraph-Herald's corporate charter was issued by the Secretary of State for the State of Iowa on or about June 10, 1960.

The Telegraph-Herald's 1,200 shares of common stock issued and outstanding were all voted in favor of the renewal of the corporate existence except the 379 shares owned by Margaret M. Quigley.

Section 491.25 of the Iowa Code, Annotated, provides as follows:

491.25 Renewal—procedure

Corporations existing for a period of years may be renewed from time to time for the same or shorter periods, or may be renewed to exist perpetually, upon compliance with the provisions of this section and other applicable statutes.

The right of renewal is vested in the stockholders and shall be exercised by a resolution thereof adopted at any regular meeting or at any special meeting called for that purpose. Such resolution must be adopted by a majority of all the votes cast at such meeting, or by such other vote as is authorized or required in the company's existing articles of incorporation.

If the renewal instrument in proper form and the necessary fees are tendered to the secretary of state for filing three months or less either prior or subsequent to the corporation's expiration date, such renewal shall take effect immediately upon the expiration of the corporation's previous period of existence, and in such case, the corporate existence shall be considered as having been extended without interruption. If the renewal is filed more than three months before or after the expiration date, such renewal shall take effect upon the date such renewal with necessary fees is accepted and filed by the secretary of state; and in cases where filed more than three months after the expiration date, shall not be in legal effect a renewal unless the procedure provided for and

the additional fees provided for in section 491.28 are fully complied with and paid.

In all cases of renewal, those stockholders voting for such renewal must purchase at its real value the stock voted against such renewal, and shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal, which purchase price shall bear interest at the rate of five percent per annum from the date of such renewal action until paid. As amended Acts 1955 (56 G. A.) ch. 229, § 1.

The majority stockholders voting to extend the corporate existence of the Telegraph-Herald, and Margaret M. Quigley were unable to agree upon the real value of the latter's stock. The majority stockholders, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased, on February 9, 1962, filed a Petition in Equity in the District Court of Iowa, in and for Dubuque County, asking the Court to determine and fix the real value of Margaret M. Quigley's stock. A decision was entered by the District Court on May 18, 1963, establishing a value of $1,750 per share. The District Court ordered that the costs be taxed 68% to the plaintiffs and 32% to the defendant. This decision was appealed by all parties to the Supreme Court of Iowa.

In the case of Woodward v. Quigley, 257 Iowa 1077, 133 N. W. 2d 38 (1965), the Supreme Court of Iowa determined the real value of Margaret M. Quigley's shares to be $1,650 per share. On rehearing the Supreme Court of Iowa, in Woodward v. Quigley, 257 Iowa 1077, 136 N. W. 2d 280 (1965), determined the real value to be $1,620 per share. The Supreme Court ordered that the costs be taxed one-half to the defendant and one-half to the plaintiffs.

Subsequent to the entry of final judgment in Woodward v. Quigley, *supra*, the 379 shares of Telegraph-Herald

stock owned by Margaret M. Quigley were purchased on July 16, 1965, by the majority stockholders voting to extend the corporate existence of the Telegraph-Herald, as follows:

Purchaser	Number of Shares Purchased
F. W. Woodward	184
F. R. Woodward	27
M. Jeanne Woodward	25
Trust No. 1	92
Trust No. 2	46
Estate of Ellen Murphy	5
Total	379

During the taxable year 1963 the majority stockholders voting to extend the corporate existence of the Telegraph-Herald, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, deceased, paid attorneys', accountants' and appraisers' fees, costs and disbursements in the total amount of $37,890.75 for services rendered in connection with the determination of the real value of Margaret M. Quigley's stock as follows:

Description of Expense	Amount of Payment
Clewell, Cooney & Fuerste (Attorneys' Fees)	$17,224.14
American Appraisal Company	8,684.40
Ernst & Ernst (Accounting Fees)	5,485.00
Reporting Services	4,635.76
Miscellaneous	1,861.45
Total	$37,890.75

The proportionate share of the fees, costs and disbursements paid by Fred W. Woodward, during the taxable year 1963 was $20,072.23.

The proportionate share of the fees, costs and disbursements paid by F. R. Woodward and M. Jeanne Woodward during the taxable year 1963 was $5,931.51.

The respective petitioners claimed the above amounts as itemized deductions described as 'professional fees incurred in relation to income-producing property' on their returns for 1963.

The fees, costs and disbursements set forth above were reasonable in amount and were incurred in connection with the determination of the value of the Quigley stock, except for the amounts of $185 in the case of Fred W. and Elsie M. Woodward, and $85 in the case of F. R. and M. Jeanne Woodward, which amounts were paid for professional services in the preparation of various tax returns and are conceded to be deductible.

Respondent disallowed the deductions with the explanation that the amounts claimed "for 'Professional fees incurred in relation to income producing property' is not allowable because the fees represent capital expenditures incurred in connection with the acquisition of capital stock of a corporation, Telegraph Herald, instead of deductible expenditures."

We think respondent was clearly correct in his disallowance.

Petitioners contend that the expenses of the litigation are deductible under section 212 of the Internal Revenue Code of 1954[1] (formerly section 23 (a) (2) of the 1939

[1] **Sec. 212. Expenses for Production of Income.**

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property for the production of income; or

* * * * * * *

Code), as ordinary and necessary expenses paid for the production of income, or for the management, conservation, or maintenance of property held for the production of income.

Respondent's position based on the deficiency notice is that the litigation expenses in question were capital expenditures incurred in connection with the acquisition of capital stock and are therefore nondeductible under the provisions of section 263 of the Internal Revenue Code of 1954[2] and section 1.263 (a)-2 (c) and (e)[3] of the Regulations promulgated thereunder, as well as section 1.212-1 (k) and (n)[4] of the Regulations.

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[2] PART IX—ITEMS NOT DEDUCTIBLE

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Section 263. Capital expenditures.

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Sec. 263. Capital Expenditures.

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(a) General Rule.—No deduction shall be allowed for—

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[3] Income Tax Regulations. Section 1.263 (a)-2 Examples of capital expenditures.

The following paragraphs of this section include examples of capital expenditures:

(c) The cost of defending or perfecting title to property.

• • • • • • •

(e) Commissions paid in purchasing securities. • • •

[4] Income Tax Regulations. Section 1.212-1 Nontrade or nonbusiness expenses.

• • • • • • •

(k) Expenses paid or incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in gross income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses.

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(n) Capital expenditures are not allowable as nontrade or nonbusiness expenses. The deduction of an item otherwise allowable under section 212 will not be disallowed simply because

Petitioners wanted to renew and extend the corporate existence of Telegraph-Herald. To reach this end they had to comply with the sections of the Iowa Code governing such a transaction. Those sections required petitioners in precise language to "**purchase** at its real value the stock voted against such renewal." (Emphasis supplied.) That is what they did; petitioners purchased the stock; but since they were unable to agree on its "real value" with the non-voting stockholders, they litigated that question and incurred the expenditures which they seek to deduct. The value-setting litigation and its attendant expenses were directly tied to the stock purchase and the expenses were part of the cost of the stock. As such, the expenses were clearly capital expenditures. The fact that the purchase was motivated by a desire to extend the corporate life is immaterial. **Atzingen-Whitehouse Dairy, Inc.**, 36 T. C. 173, 183 (1961).

Both parties argue extensively that the expenditures here involved were or were not made in defense or perfection of title to the stock and so were or were not capital expenditures. Petitioners also argue that the "primary purpose" of the litigation was to determine the real value of the shares of the dissenting stockholder and that title to such shares was not at issue or in dispute. These contentions are beside the point and simply cloud the real issue.

To summarize, petitioners found themselves in the position of having to buy the stock of a fellow shareholder.

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the taxpayer was entitled under subtitle A of the Code to treat such item as a capital expenditure, rather than to deduct it as an expense. For example, see section 266. Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in subtitle A of the Code, no deduction is allowable under section 212; and this is true regardless of whether any basis adjustment is allowed under any other provision of the Code.

Litigation was necessary to settle the price of the stock. The expenses in question were incurred in that litigation and no other. The result was the purchase of shares of stock by a group of shareholders from another shareholder at the litigated price. For all the record shows, petitioners still own the shares they purchased. Acquisition costs of property are not deductible. **John S. Lucas, et ux. v. Commissioner,** ... F. 2d ... (C. A. 1, No. 2907, 12/8/67), affirming a Memorandum Opinion of this Court. The expenditures were capital in nature to be added to the cost of the shares and are not deductible. **Atzingen-Whitehouse Dairy, Inc.,** *supra.*[5]

Reviewed by the Court.

Decisions will be entered under Rule 50.

Bruce, J., dissenting: In my opinion the majority has erred in at least three important respects in determining that the litigation expenses in question were nondeductible capital expenditures.

First, the majority, although the only issue presented in the state court litigation out of which the expenses in question arose was the "real value" of the stock owned by Margaret M. Quigley and title to such stock was not at issue or in dispute has failed to give effect to the primary purpose test which this and many other courts have recognized as controlling in the determination of the character of litigation expenses. The mere statement that such

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[5] Petitioners rely heavily on **Walter S. Heller,** 2 T. C. 371, affd. 147 F. 2d 376, on this issue, under the so-called "Dobson rule." That case involved the other side of the coin, i. e., sellers' expenses rather than purchasers' outlays. We do not think it is necessarily applicable here. If further reading is desirable see "Non-Business Expenses Relating to Property," William T. Plumb, Jr., American University Tax Institute Lectures, Vol. 2, pp. 357-360 and 4A Mertens, Law of Federal Income Taxation, sec. 25A.14, p. 40.

a question clouds the issue here presented is certainly not sufficient.

Secondly, the majority opinion is contrary to prior decisions of this and other courts, in particular, **Walter S. Heller**, 2 T. C. 371, affd. 147 F. 2d 376 (C. A. 9, 1945), certiorari denied 325 U. S. 868, and **Smith Hotel Enterprises, Inc. v. Nelson**, 236 F. Supp. 303 (D. C. Wisc., 1964), both of which involved state statutes similar to the Iowa statute involved herein. See also **Naylor v. Commissioner**, 203 F. 2d 346 (C. A. 5, 1953), reversing and remanding 17 T. C. 959. Both **Heller** and **Naylor**, *supra*, were followed by this Court in **Raymond K. Dykema**, a Memorandum Opinion dated April 28, 1953, remanded by the Court of Appeals for the Sixth Circuit only because of an inconsistency in the findings affecting a part of the expenses involved. The rationale of the **Naylor** case was also approved in a court reviewed opinion of this Court, **Otto C. Doering, Jr.**, 39 T. C. 647, 650, affirmed 335 F. 2d 738 (C. A. 2, 1964), on other grounds. Although sometimes criticized, apparently for factual reasons, neither **Heller** nor **Naylor** has ever been overruled. The distinction of the **Heller** case suggested in footnote 5 of the majority opinion is hardly a valid one. In my opinion it is immaterial whether the purchaser or the seller instituted the litigation in question. I see no reason for treating the purchaser different than the seller.

Thirdly, **Atzingen-Whitehouse Dairy, Inc.**, 36 T. C. 173, cited by the majority in support of its conclusion is clearly distinguishable on its facts. In that case there was no litigation of any character which might have required consideration of the **primary purpose test.** See **Naylor v. Commissioner**, *supra*. The only fees involved were those paid an attorney for attending conferences, preparing agreements and handling other details necessary to consummate the purchase by a corporation of the stock of two

dissident stockholders. **Lucas v. Commissioner,** ... F. 2d ... (C. A. 1, Dec. 8, 1967), cited by the majority, is also factually distinguishable from the present case.

In my opinion, the litigation expenses incurred and paid by the petitioners in connection with the case of **Woodward v. Quigley,** 257 Iowa 1077, 133 N. W. 2d 38, on rehearing 136 N. W. 2d 280 (1965), were ordinary and necessary expenses paid for the management, conservation, or maintenance of property held for the production of income and as such, are deductible under the provisions of section 212 of the Internal Revenue Code of 1954.

Petitioners contend that **Woodward v. Quigley,** *supra,* out of which the litigation expenses in question arose, was an equitable action, the primary purpose of which was to determine the "real value" of the shares of stock owned by the dissenting stockholder, Margaret M. Quigley, and that the title to such stock was not at issue or in dispute.

As a general rule, the courts have consistently recognized that expenditures made in defense or perfection of title to capital assets are capital expenditures and are not deductible as ordinary and necessary expenses whether incurred in a trade or business or in connection with a nonbusiness transaction. **Spangler v. Commissioner,** 323 F. 2d 913 (C. A. 9, 1963), affirming a Memorandum Opinion of this Court; **Robert L. Wilson,** 37 T. C. 230, affd. per curiam 313 F. 2d 636 (C. A. 5, 1963); **Industrial Aggregate Company v. United States,** 284 F. 2d 639 (C. A. 8, 1960). It has also been held that litigation or other expenses incurred in the acquisition of stock or other capital assets are capital expenditures constituting a part of the cost of property and are not deductible. See **Helvering v. Winmill,** 305 U. S. 79 (1938), involving brokers' purchase commissions; **Atzingen-Whitehouse Dairy, Inc.,** 36 T. C. 173 (1961), involving fees paid an attorney for attending conferences, preparing agreements and handling

other details necessary to consummate the purchase by the corporation of the stock of two dissident stockholders; **Iowa Southern Utilities Company v. Commissioner,** 333 F. 2d 382 (C. A. 8, 1964), certiorari denied 379 U. S. 946, affirming a Memorandum Opinion of this Court, wherein it was held that attorneys' fees and expenses incurred in a successful stockholders' derivative action and directed to be paid by the corporation were related to the recovery of capital assets and were not deductible as "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" under section 162 (a) of the Internal Revenue Code of 1954; **Robert L. Wilson,** *supra*, which held that legal expenses paid by a widow in perfecting her dower interest in the decedent's property were capital expenditures, non-deductible under section 212 of the Internal Revenue Code of 1954.

At the same time, as was clearly pointed out by the Court of Appeals for the Eighth Circuit in **Industrial Aggregate Company v. United States,** *supra*, at p. 645, and in **Iowa Southern Utilities Company v. Commissioner,** *supra*, at pp. 385 and 386, the mere fact that title to property happens to be involved in litigation does not necessarily mean that the litigation expenses are not deductible. The test is that of primary purpose. In the **Industrial Aggregate Company** case, the Court stated:

> At the same time, ever since Kornhauser v. United States, 276 U. S. 145, 48 S. Ct. 219, 72 L. Ed. 505, cases recognize that the mere fact that title to property happens to be involved in litigation does not necessarily mean that expenditures of that litigation are automatically rendered nondeductible by the regulation. An example is Levitt & Sons v. Nunan, 2 Cir., 142 F. 2d 795, 797. Practicality and substance are to be recognized. The test which appears to have been

established is that of primary purpose. Thus, if the primary or sole purpose of the suit is to perfect or defend title, the expenditures are not deductible. Shipp v. Commissioner, 9 Cir., 217 F. 2d 401, 402; Lewis v. Commissioner, 2 Cir., 253 F. 2d 821, 827-828; Garrett v. Crenshaw, 4 Cir., 196 F. 2d 185, 187; Addison v. Commissioner, 8 Cir., supra, at page 523 of 177 F. 2d. On the other hand, even though title may be involved, if its defense or perfection is not the primary purpose of the litigation, the expenditures do not encounter the barrier of the regulation's standard and they may qualify instead as ordinary and necessary expenses. Rassenfoss v. Commissioner, 7 Cir., 158 F. 2d 764, 767-768; Sergievsky v. McNamara, D. C. S. D. N. Y., 135 F. Supp. 233, 237-238; Straub v. Granger, D. C. W. D. Pa., 143 F. Supp. 250, 254-255.[10]

[Footnotes omitted.]

See also Manufacturers Hanover Trust Co. v. United States, 312 F. 2d 785, 789 (Ct. Cl., 1963).

As was noted by the Court of Appeals for the Eighth Circuit in Industrial Aggregate Company v. United States, *supra*, in footnote 10 at page 645, the line of demarkation is not always apparent and each case is to be examined and decided on its own facts.

Under section 491.25 of the Iowa Statutes, as interpreted by the Supreme Court of Iowa in **State v. Shellsburg Grain & Lumber Co.**, 243 Iowa 734, 53 N. W. 2d 143 (1952); **Terrell v. Ringgold County Mut. Telephone Co.**, 225 Iowa 994, 282 N. W. 702 (1938); and **Melsha v. Tribune Pub. Co.**, 243 Iowa 350, 51 N. W. 2d 425 (1952), the duty of the majority stockholders to purchase the stock of the dissenting stockholder arose as of the date the vote for renewal was taken. The statute imposed no duty on the corporation, as such, to purchase the stock of the dissent-

ing stockholder, and its purchase by the majority stockholders was neither a condition precedent to the renewal of the corporate charter nor a condition subsequent to the continued existence of the corporation. The renewal of the corporate charter was effective upon the expiration of the existing charter. As held by the court in **State v. Shellsburg Grain & Lumber Co.**, *supra*, the extent and nature of the liability created by the vote for renewal of the corporate charter were matters of a purely private right between the two groups of stockholders to be determined in a proper proceeding.

The case of **Woodward v. Quigley**, *supra*, was brought to resolve such a purely private right between the majority and dissenting stockholders. The corporation was not a party thereto and the action did not involve its business operations. The stock which petitioners owned in Telegraph-Herald was held by them for investment purposes and the extension of the life of the corporation was necessary to the management, conservation, or maintenance of such property. The majority stockholders recognized their obligation under the Iowa statute to purchase the stock of the dissenting stockholder.[6] The majority stockholders were interested in minimizing the value of the stock whereas the dissenting stockholder was interested in a high valuation. Being unable to agree upon the "real value" of the stock in question, the primary, and, in fact, the only purpose of the litigation was to obtain a court determination of the real value of the

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[6] The first opinion of the Supreme Court of Iowa stated (133 N. W. 2d 38, 40):

> Plaintiffs recognize their obligation to purchase the stock under this statute, but the parties have been unable to agree on the "real value" of defendant's stock. This action was brought by the majority stockholders to secure a court determination of the "real value." The trial court established a value of $1,750 per share and both parties have appealed.

See also **Robbins v. Beatty**, 67 N. W. 2d 12 (Iowa, 1954).

stock. Neither a money judgment nor the enforcement of a contract or statutory obligation was sought or determined. Title to the stock was never in question, and was only incidentally involved.[7] Title remained in the dissenting stockholder until, on July 16, 1965, the majority stockholders purchased the shares of stock owned by the dissenting stockholder, Margaret M. Quigley. The amounts paid for such stock are not involved in this proceeding.

In my opinion the litigation expenses incurred and paid by petitioners in connection with the above-entitled action are deductible, under the provisions of section 212 of the Internal Revenue Code of 1954, in ordinary and necessary expenses paid for the production of income, or for the management, conservation, or maintenance of property held for the production of income. I would so hold.

The parties have cited three cases involving state statutes somewhat similar to the Iowa statute involved herein. Two of the cases cited by petitioners support the conclusion I have reached in this proceeding; one cited by respondent reached a different conclusion.

In **Walter S. Heller**, 2 T. C. 371, affd. 147 F. 2d 376 (C. A. 9, 1945), certiorari denied 325 U. S. 868, cited by petitioners, the issue was whether legal fees and expenses paid by a dissenting stockholder, in connection with litigation to determine the value and to enforce his rights to the cash value of his shares pursuant to a California statute providing that stockholders not consenting to a merger or consolidation were entitled to be paid such

[7] This is further emphasized by the fact that, although the Iowa statute imposed an obligation on the majority stockholders to purchase the stock of the dissenting stockholder, there is nothing in the statute or in the decisions of the Iowa courts, which would have prevented the dissenting stockholder, if she had not been satisfied with the value found by the court, from withdrawing her objection to the renewal and retaining her stock. Thus, a sale of the stock might not have taken place.

value, were deductible as expenses for the production or collection of income or in the management of property held for the production of income. This Court stated (p. 374):

> The attorneys' fee paid by petitioner, while relating to a capital asset, bore a reasonable and proximate relation to the production or collection of income, and to the management of property held for that purpose. The litigation did not, as respondent urges, involve a defense by petitioner of his rights in, and his title to, the stock. The statute under which it was instituted pre-supposes that the 'dissenting stockholders' own the shares which they are seeking to have appraised. The litigation concerned the exercise by petitioner of his right to receive cash for his shares and the determination of the amount thereof, he not having approved the contemplated merger or consolidation and having taken the other steps required by the statute. As a result of that litigation the fair market value of his stock was determined and paid to him in 1938. The attorneys' fee in our judgment was paid for services rendered in connection with "the production or collection of income," and in connection with "the management * * * of property held for the production of income." Respondent therefore erred in disallowing the claimed deduction.

In **Smith Hotel Enterprises, Inc. v. Nelson,** 236 F. Supp. 303 (D. C. Wisc., 1964) also cited by the petitioners, the corporation agreed to sell substantially all its assets, and under a Wisconsin statute was required to purchase the stock of dissenting stockholders. It paid legal and other professional expenses in litigation to determine the fair value of the shares. The District Court held the deduction of such expenses was proper as an ordinary and necessary business expense, citing **Heller,** *supra.* The Court disagreed with the contrary holding in **Boulder**

Building Corporation v. United States, 125 F. Supp. 512 (D. C. Okla., 1954), stating (at p. 305):

> Counsel for the plaintiff urges that the decision in Boulder is unsound in that it disregards the fact that the taxpayer's obligation to purchase the dissenters' stock was an involuntary obligation. Under the Oklahoma statute, as well as under the Wisconsin statute, once the dissenters have demanded that the corporation purchase their shares at fair value, the corporation has no choice in the matter. After the demand has been made, the corporation's main concern is with keeping its liability to a minimum. Plaintiff's argument is sound. Viewed in this light it appears that the primary purpose of the state litigation in the instant case was a determination of the fair value of the shares, and the involvement of title was incidental. The deduction made by the taxpayer was proper as an ordinary and necessary business expense.

In **Boulder Building Corporation v. United States,** *supra*, which is strongly relied upon by respondent, a majority of the stockholders of an Oklahoma corporation, in acordance with the provisions of an Oklahoma statute, authorized the board of directors to extend the then expiring corporate life of the company, to enlarge and amend its corporate powers and to change its name. A minority of the stockholders demanded that the corporation purchase the minority stock at fair value as provided by the statute, and, when the two factions were unable to agree on the value of the stock, filed an action in the state district court to gain a judicial determination of the stock's value. In connection with this litigation the company paid certain appraisers' and attorneys' fees, which the Commissioner disallowed as ordinary and necessary business expense deductions. The United States District Court for the Western District of Oklahoma held that such expenditures "cannot be deemed an expense

arising out of ordinary business operation but must be considered an expenditure directly related to the acquisition of capital stock."

It does not appear that the District Court was aware of, or considered the opinion of this Court (affirmed by the Ninth Circuit Court of Appeals) in the case of **Walter S. Heller**, *supra*, which reached a different conclusion on substantially analogous facts. Moreover, in my opinion, the decision in **Boulder Building Corporation** is not sound. Although stating that the "fundamental contest," the "paramount issue," the "sole question," the "fundamental issue" in the state court litigation was to determine the fair value of the stock held by the miniority stockholders, the Court stated: "It cannot reasonably be argued that title to the stock was involved only incidentally." This conclusion, in my opinion, failed to give effect to the primary purpose test and was unsound. In any event, I think the facts in the present case require a different conclusion and would so hold.

Fay, J., dissenting: I agree with much that Judge Bruce says in his dissenting opinion. I believe the facts of this case are indistinguishable from those in **Walter S. Heller**, 2 T. C. 371 (1943), affd. 147 F. 2d 376 (C. A. 9, 1945). In the opinion in that case we said, at p. 374:

> The litigation concerned the exercise by petitioner of his right to receive cash for his shares and the determination of the amount thereof, he not having approved the contemplated merger or consolidation and having taken the other steps required by the statute. As a result of that litigation the fair market value of his stock was determined and paid to him in 1938. The attorneys' fee in our judgment was paid for services rendered in connection with "the production or collection of income," and in connection

with "the management * * * of property held for the production of income." Respondent therefore erred in disallowing the claimed deduction.

The majority has not seen fit to overrule **Heller**. I think it should govern the disposition of the present case.

DECISION
of the
TAX COURT OF THE UNITED STATES

Fred W. Woodward and Elsie M. Woodward, Petitioners

v

Commissioner of Internal Revenue, Respondent

Docket No. 4363-65

Entered February 23, 1968

Pursuant to the opinion of the Court filed January 23, 1968, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

Ordered and Decided: That there is a deficiency in income tax due from the petitioners for the taxable year 1963 in the amount of $9,335.24.

Norman O. Tietjens,
Judge.

DECISION
of the
TAX COURT OF THE UNITED STATES

re

F. R. Woodward and M. Jeanne Woodward, Petitioners

v

Commissioner of Internal Revenue, Respondent

Docket No. 4364-65

Entered February 23, 1968

Pursuant to the opinion of the Court filed January 23, 1968, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

Ordered and Decided: That there is a deficiency in income tax due from the petitioners for the taxable year 1963 in the amount of $3,074.99.

Norman O. Tietjens,
Judge.

OPINION

Filed May 2, 1969
of the
UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 19,386

Fred W. Woodward and Elsie M. Woodward,
F. R. Woodward and M. Jeanne Woodward
Petitioners

v

Commissioner of Internal Revenue
Respondent

Petition for Review of the Decision of the
Tax Court of the United States

(May 2, 1969)

Before Matthes, Mehaffy and Lay, Circuit Judges

This case is before us on petition to review the decision of the Tax Court sustaining the determination by the Commissioner of Internal Revenue of deficiencies in the petitioners' income taxes for the year 1963. 49 T. C. 377 (1968) (opinion by Judge Tietjens reviewed by the entire court, with Judge Bruce and Fay dissenting).

The deficiencies result from deductions of litigation expenses incurred in connection with the acquisition of

shares of stock by the petitioners. The petitioners contend that these expenses were incurred for the conservation, management or maintenance of property held for the production of income and thus deductible under § 212 of the Internal Revenue Code of 1954 which provides:

> "In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—
>
> (1) for the production or collection of income;
>
> (2) for the management, conservation, or maintenance of property held for the production of income; . . ."

The Commissioner, on the other hand, maintains that the expenses were capital expenditures under § 263 of the 1954 Code (hereinafter referred to as "§ 263") which must be added to the basis of the property rather than deducted from gross income. Section 263 provides:

> "No deduction shall be allowed for—
>
> (1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to—(exceptions, irrelevant to this case, omitted) . . .
>
> (2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made. . . ."

Together the petitioners owned a majority interest in the Telegraph Herald, an Iowa corporation. The charter of the corporation was due to expire in 1961. The stockholders met on June 9, 1960, and by majority vote adopted a resolution extending the corporate existence of Telegraph Herald perpetually. A certificate for the renewal of the corporate charter was issued by the Secretary of the State of Iowa shortly thereafter.

The only shareholder voting against renewal was Margaret M. Quigley, who owned 379 of the 1,200 shares issued and outstanding. Under the corporate laws of Iowa it was provided that:

> "In all cases of renewal, those stockholders voting for such renewal must purchase at its real value the stock voted against such renewal, and shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal, which purchase price shall bear interest at the rate of five per cent per annum from the date of such renewal action until paid." Ia. Code § 491.25 (1958).

On February 9, 1962, all the majority stockholders, except one, joined in filing a petition in the District Court of Iowa, Dubuque County, seeking a determination of the real value of the Quigley stock. The value was determined by the district court to be $1,750 per share. This figure was lowered by the Supreme Court of Iowa to $1,650 per share. **Woodward v. Quigley**, 257 Ia. 1077, 133 N. W. 2d 38 (1965). On rehearing, the value was further reduced to $1,620. **Woodward v. Quigley**, 257 Ia. 1077, 1104, 136 N. W. 2d 280 (1965). After the entry of final judgment in the case, the minority stockholders, on July 16, 1965, purchased the stock.

During 1963 petitioners paid attorneys', accountants' and appraisers' fees along with other costs of services rendered in connection with the determination of the value of Mrs. Quigley's stock. The respective taxpayers deducted their proportionate shares of these expenses on their income tax returns for 1963, describing them as "professional fees incurred in relation to income-producing property." The Commissioner disallowed the deductions "because the fees represent capital expenditures incurred in connection with the acquisition of capital stock

of a corporation." The taxpayers timely filed petitions in the Tax Court for a redetermination of the deficiencies. As stated, the Tax Court upheld the Commissioner's action.

It has long been the government's view that the cost of defending or perfecting title to property is a capital expenditure. 26 C. F. R. § 1.263 (a)—2 (c) (1968).[1] The courts have accepted this view, 4A Mertens, Law of Fed. Income Taxation, §§ 25.24, 25A.16 (1966), but have added the restriction that not all expenses of litigation wherein title is involved are capital expenditures. If litigation arises concerning the title to property held by the taxpayer, the courts will look to the primary purpose of the litigation to determine the deductibility of litigation expenses.

> "Thus, if the primary or sole purpose of the suit is to perfect or defend title, the expenditures are not deductible. * * * On the other hand, even though title may be involved, if its defense or perfection is not the primary purpose of the litigation, the expenditures do not encounter the barrier of the regulation's standard and they may qualify instead as ordinary and necessary expenses. **Industrial Aggregate Co. v. United States**, 284 F. 2d 639, 645 (8th Cir. 1960) (citations omitted).

In the latter instance the expenses are currently deductible from gross income under section 162 or 212 of the Internal Revenue Code of 1954 (formerly § 23 (a) (1) and § 23 (a) (2), respectively of the Internal Revenue

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[1] 26 C. F. R., § 1.263 (a)—(2) provides:

"The following paragraphs of this section include examples of capital expenditures:

* * * * * * * *

"(c) The cost of defending or perfecting title to property."

Code of 1939 and hereinafter referred to as "§ 162" and "§ 212").[2]

Petitioners would extend the primary purpose test to litigation expenses incurred in the acquisition of property. They take the position that since the purpose of the litigation below was merely to value shares which the taxpayers were required by law to purchase—rather than to perfect, defend or acquire title—the expenditures were incurred for the management, conservation or maintenance of property held for the production of income, and thus deductible under § 212.

The Commissioner argues, and the Tax Court held, that the primary purpose doctrine has no application to litigation expenses directly connected with the acquisition of a capital asset. According to this view, that doctrine becomes operative only when, having acquired property, a taxpayer incurs expenditures to defend or perfect title thereto. Accepting this view of the matter, the Tax Court found that the "value-setting litigation and its attendant expenses were directly tied to the stock purchase and the expenses were part of the cost of the stock. As such, the

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[2] Section 162, as amended, provides:

"Trade or business expenses—(a)

In general. There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity." • • •

expenses were clearly capital expenditures," under § 263 of the 1954 Code. 49 T. C. at 382.

Petitioners' reliance on the primary purpose test is misplaced. As we have mentioned, that test developed from the uncertainty surrounding the effect of Treas. Reg. 1.263 (a)—2 (c), which gives as an example of a capital expenditure "the cost of defending or perfecting title to property." Rather, this case involves the cost of acquisition of property. We thus have no need to apply the primary purpose test, a test which would only be relevant to a situation where the taxpayer's ownership of or interest in a capital asset is challenged. This was the situation in **Industrial Aggregate Co. v. United States**, *supra*, where litigation expenses were incurred in connection with a dispute concerning leases which taxpayer had held for many years. In that case we applied the primary purpose test to find the litigation expenses deductible.

The test was also recognized in **Iowa Southern Util. Co. v. Commissioner**, 333 F. 2d 382 (8th Cir.), **cert. denied**, 379 U. S. 946 (1964). There, shareholders of the taxpayer corporation brought a derivative action against the corporations' majority shareholders and former president and others, on the theory that they had secretly acquired properties at prices for less than those at which they turned them in to the taxpayer (corporation). The corporation was not allowed to deduct the litigation expenses as ordinary and necessary business expenses under § 162. While we recognized the primary purpose test in that opinion, we did not apply the test to the facts of that case. Instead, Judge Blackmun, in reaching the decision that the litigation expenses represented capital expenditures, relied on several factors to be discussed later. Apparently the court treated the expenses as incidental to the earlier purchase of the capital assets. See **Spangler v. Commissioner**, 323 F. 2d 913, 921 (9th Cir. 1963) and

Munson v. McGinnes, 283 F. 2d 333 (3d Cir.), **cert. denied**, 364 U. S. 880 (1960).

Petitioners also suggest that they obtained equitable title to the stock on the date the shareholders voted against corporate renewal. They argue the purchase was subject only to valuation and payment of the purchase price. Based upon this premise, it is asserted that the expenses were not incurred to perfect title or to purchase and thus were not capital expenditures.

Iowa law does not support the taxpayer's premise. The only Iowa cases cited by petitioners are **Woodward v. Quigley**, *supra*; **Robbins v. Beatty**, 246 Ia. 80, 67 N. W. 2d 12 (1954); **State v. Shellsburg Grain and Lumber Co.**, 243 Ia. 734, 53 N. W. 2d 143 (1952); **Melsha v. Tribune Publishing Co.**, 243 Ia. 350, 51 N. W. 2d 425 (1952); and **Terrell v. Ringgold County Mut. Tel. Co.**, 225 Ia. 994, 282 N. W. 702 (1938). Even Judge Bruce in his dissent was unable to read into the above cases the rule espoused by the Petitioners. He stated:

> "There is nothing in the statute or in the decisions of the Iowa courts, which would have prevented the dissenting stockholder, if she had not been satisfied with the value found by the court, from withdrawing her objection to the renewal and retaining her stock. Thus, a sale of the stock might not have taken place." 49 T. C. 377, 386 at n. 2 (1968).

Assuming arguendo the validity of petitioners' premise, however, the conclusion they reach does not follow. There are several cases concerning litigation expenses incurred by the holder of equitable title of property to **perfect** his legal title. See **Spangler v. Commissioner**, *supra*, at 920, notes 16, 17. The authorities differ on whether these costs are deductible expenses or capital expenditures. **Contrast Allen v. Selig**, 200 F. 487 (5th Cir. 1952) (expenses

deductible under predecessor to § 212) **with Garrett v. Crenshaw,** 196 F. 2d 185 (4th Cir. 1952) (capital expenditures). We need not choose one of these divergent views because those cases did not concern the **acquisition** of property. Rather, the taxpayers were seeking to obtain legal recognition of their title. This purpose was not connected with the original acquisition of the property. What we have here, however, is litigation directly connected with the purchase of property. The expenses were incurred to establish the value of the capital assets acquired and were much like brokerage fees. They were part of the cost of acquisition. **Davis v. Commissioner,** 151 F. 2d 441 (8th Cir. 1945), **cert. denied,** 327 U. S. 783 (1946). And **see Johnson & Co. v. United States,** 149 F. 2d 851 (2d Cir. 1945).

This case may best be viewed against the historical background of the provision under which the deduction is claimed. Prior to the 1942 amendments to the Internal Revenue Code of 1939, expenses incurred for the production of income which could not meet the strict standards of "business" expenses were not deductible from gross income. **Higgins v. Commissioner,** 312 U. S. 212 (1941); 4A Mertens, § 25A.01 (1966). To remedy this situation Congress enacted § 23 (a) (2) of the Code.[3] Section 212 of the Internal Revenue Code of 1954, set forth above, adopted the essential provisions of § 23 (a) (2) (with additions not pertinent here).

After the passage of § 23 (a) (2) there was debate over what types of expenditures were deductible under the provision. 4A Mertens, § 25A.14, n. 55. **See** Nahstoll, Non-Trade and Non-Business Expense Deductions, 46 Mich. L.

[3] This provision allowed deductions for, "[I]n the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

Rev. 1015, 1026 (1948). There was a feeling, which still prevails among some commentators, that the broad definition of a capital expenditure as distinguished from a business expense under §23 (a) (1), the predecessor to § 162 of the 1954 Code, was inapplicable to expenses deductible under § 23 (a) (2). Brookes, Litigation Expenses and the Income Tax, 12 Tax L. Rev. 241, 251-63 (1957); McDonald, Deduction of Attorneys' Fees for Federal Income Tax Purposes, 103 U. Pa.. L. Rev. 168, 184-89 (1954); Comment, Federal Income Tax Treatment of Attorneys' Fees, 40 Tex. L. Rev. 137, 146 (1961). However, it was determined that the two provisions were in *para materia* **Trust of Bingham v. Commissioner**, 325 U. S. 365, 373 (1945); **Iowa Southern**, *supra*, at 386; **Munson v. McGinnes**, *supra*, at 336; **see McDonald v. Commissioner**, 323 U. S. 57, 62 (1944), and the rule evolved that expenses deductible under § 212 are subject to the same limitations as § 162 expenses except for the "non-business" aspect of the former. **Trust of Bingham**, *supra*, at 374-75; **McDonald v. Commissioner**, *supra*, at 62; **Lucas v. Commissioner**, 388 F. 2d 472, 474 (1st Cir. 1967); **Iowa Southern**, *supra*, at 386; **Spangler v. Commissioner**, *supra*, at 918; 4A Mertens, § 25A.04. In particular, capital expenditures are not deductible under § 212, just as they are not deductible under § 162. **Lucas v. Commissioner**, *supra*, at 474; **Spangler v. Commissioner**, *supra*, at 918-19; **Munson v. McGinnes**, *supra*, at 335; 4A Mertens, § 25A.14.[4]

Setting aside for the moment consideration of the capital aspects of this transaction, it is difficult to comprehend how these expenses were incurred "for the management, conservation, or maintenance of property held for the production of income." What is the property conserved?

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[4] The opinions in both **Iowa Southern**, *supra*, and **Spangler v. Commissioner**, *supra*, contain excellent discussions of the history and scope of § 212.

Petitioners suggest that it was their cash; that is to say, the less money the petitioners had to pay for the stock the more money they would "conserve." This contention is wholly without substance. Section 212 was not designed to allow tax deductions for the preservation of one's net worth. To come within the scope of § 212, the petitioners are forced to argue that through the valuation proceedings they were conserving either (1) the shares of stock they held as majority shareholders, or (2) the shares of stock they were required to purchase. In our view neither theory is sound. The first is not persuasive, because under Iowa law the charter of the corporation was renewed upon affirmative action of the majority. Their interest in the corporation and the value of their shares remained unaffected. The second theory is, as we have seen, unsupported by Iowa law. Neither the statute nor the cases indicate that the petitioners became the actual owners of the stock until the purchase was consummated by payment of the value determined by the Supreme Court of Iowa.

The general rule is that expenses incurred in acquiring or disposing of property are capital expenditures. See, *e. g.*, **Lucas v. Commissioner**, *supra*, at 474; **Munson v. McGinnes**, *supra*, at 335; **Jones' Estate v. Commissioner**, 127 F. 2d 231, 232 (5th Cir. 1942). See also 4A Mertens, § 25A.15 and the cases there cited. The expenditures here fall within that category. They "related directly" to the acquisition of capital assets. **Iowa Southern**, *supra*, at 388. The property would never have been acquired had not the value been established and paid. As was stated in **Munson v. McGinnes**, *supra*, at 335, "if the problem is to reach mutually satisfactory or binding terms of sale . . . the question of capitalization must be faced." That is precisely the situation we have here. It is similar to that involved in **Ward v. Commissioner**, 224 F. 2d 547 (9th

Cir. 1955), where the seller was required to capitalize attorneys' expenses incurred in getting a higher price for the property sold. And see **Johnson & Co. v. United States**, *supra*, where litigation expenses incurred in valuing condemned property, the title to which had already passed to the purchaser, were held to be capital expenditures.

We regard our conclusion as consistent with the reasoning and result of our **Iowa Southern** decision, *supra*. There the state court action "had to do with the excess of the purchase prices paid by the taxpayer for assets transferred to it." *Id.* at 388. Here the state action concerned the amount to be paid for assets to be received. In **Iowa Southern** we recognized, "purchase prices, incontrovertibly, are capital in character. . . . What we desired in the state action was an adjustment in the prices," and thus, "the fees and expenses incurred related directly to capital." Here the state action also concerned the amount to be paid for the capital asset and was thus "related directly" to capital.

Again in **Iowa Southern** "the transferred assets were non-cash in character and were basis properties." The same is true here. And the excess amounts received by the taxpayer in **Iowa Southern** "could logically be expected to have pertinency in the adjustment of basis." Here the amount paid by the taxpayer has a logical pertinence to the adjustment of basis. In fact the amount paid, including acquisition expenses, is the basis.

Finally, we noted in **Iowa Southern that it is the** "origin **of the liability**" and "**the kind of transaction out of which the obligation arose**" that is crucial. While these phrases were originally spoken in another context, **United States v. Gilmore**, 372 U. S. 39, 47-48 (1963) and **Deputy v. DuPont**, 308 U. S. 488, 494, 496 (1940), we believe that the "kind

of transaction" is important in the determination of whether an expense is currently deductible or must be capitalized. The transaction involved here was the purchase of capital assets. The valuation of these assets was vital to the purchase, and the litigation necessary for valuation was thus an integral part of the overall transaction.

Our attention is directed by the Petitioners to several decisions involving problems similar to the one before us. It will be noted that some of these cases involve the seller's side of the transaction. While we do not express any opinion as to whether the outcome would differ were the seller involved in this case, we do recognize a distinguishing characteristic in the seller's position. Until the property is valued and the price is paid by the purchaser, the seller still owns the property. There is not the conceptual difficulty with the phrase, "property held for the production or income," that is present here.

The first case relied upon by the taxpayers is **Heller v. Commissioner**, 2 T. C. 371 (1943), **aff'd.**, 147 F. 2d 376 (9th Cir.), cer. denied, 325 U. S. 868 (1945). There the taxpayer, a dissenting shareholder, demanded the cash value of his shares rather than the stock of another corporation in a corporate acquisition. He instituted litigation pursuant to the California corporation laws for appraisal of the stock. The litigation expenses were held deductible by the seller under § 212 because they bore a reasonable and proximate relation to the production or collection of income and to the management of property held for that purpose.

In addition to involving the seller's side of the transaction, the **Heller** case was decided the year after the predecessor to § 212 was enacted and at a time when its scope was in doubt. Furthermore, the courts in reviewing

the Tax Court's decision were bound by the then-prevailing rule of **Dobson v. Commissioner**, 320 U. S. 489 (1943). **Allied Chem. Corp. v. United States**, 305 F. 2d 433, n. 3 at 443 (Ct. Cl. 1962) (dissenting opinion). We also note that **Heller** has been impliedly criticized by the Ninth Circuit, **Spangler v. Commissioner**, *supra*, at 919-20 n. 15, and that the Commissioner in his brief suggests that it "runs counter to the mainstream of relevant decisions in this area."

The case of **Naylor v. Commissioner**, 203 F. 2d 346 (5th Cir. 1953), while not involving a corporate reorganization or renewal, presents a problem analogous to the one at hand. There the taxpayer gave an option to buy shares which he held, with the price based on the net asset value of the company at a certain date. The purchaser exercised the option to purchase the shares, but a dispute arose over the valuation. The taxpayer hired an attorney to negotiate with the purchaser concerning the value of the shares. The expenses incurred in connection with the valuation were held to be deductible under what is now § 212.

Again we note that the taxpayer was the seller in the **Naylor** case. Furthermore, that case involved a completed sale of shares by which both parties were bound. And the court treated the problem as one of the collection of income under § 212, not as one involving property held for the production of income. See **Allied Chem. Corp v. United States**, *supra*, n. 3 at 443 (dissenting opinion). Moreover, it is significant that this case was also impliedly criticized in **Spangler v. Commissioner**, *supra*, n. 15 at 919-20. See **Commissioner v. Doering**, 335 F. 2d 738, 741, 743 (2d Cir. 1964); 4A Mertens, § 25A.16 n. 69.

There are two recent federal district court cases with similar fact situations which appear to suport the taxpayers' viewpoint. In **Smith Hotel Enterprises v. Nelson**,

236 F. Supp. 303 (E. D. Wisc. 1964), the majority of the stockholders of the corporate taxpayer agreed to sell the corporation's assets. The dissenting shareholders demanded the fair value of their stock as provided for by statute. Since no agreement on valuation of the shares could be reached, the minority shareholders petitioned for a determination of value by the court. Litigation expenses in connection with the valuation proceeding were held deductible under § 162 as business expenses. In **Hilton Hotels v. United States**, 285 F. Supp. 617 (N. D. Ill. 1968), **aff'd** ... F. 2d ... (Apr. 1969), the dissenting shareholders to a corporate merger had their shares valued in appraisal proceedings for purchase by the corporate taxpayer. The expenses of the purchasing corporation were held deductible under § 162 with the court placing heavy reliance on the **Smith Hotel** decision.

Both of these decisions found deductions under § 162 rather than under § 212, the provision involved here. The court in **Smith Hotel** applied the primary purpose test to reach its decision. For reasons previously given, we do not believe that test is applicable to our case. Moreover, the statute involved in **Hilton** specifically provided that upon objection to merger by a stockholder, his shares were deemed to have been required by the corporation. As we have seen, there is no such provision in the Iowa statutes regarding corporate renewal.

The better view regarding the tax consequences of the litigation expenses in these cases is expressed by the court in **Boulder Bldg. Corp. v. United States**, 125 F. Supp. 512 (W. D. Okla. 1954), on facts essentially identical to the facts in this case. In **Boulder**, minority shareholders of the taxpayer corporation objected unsuccessfully to renewal of the corporation's charter. They demanded that the corporation purchase their shares at a fair value in accordance with the statutory provision. Disagreement

over the value of the stock ensued, and the shareholders filed a suit for a declaration of the value. Expenses incurred by the corporation incident to these proceedings were sought to be deducted as business expenses under the predecessor to § 162 of the present Code. The court rejected this contention and found the expenses to be capital expenditures because they were incurred "in connection with the acquisition of stock." *Id.* at 515-16.

In summary, the transaction involved the purchase of capital assets. The valuation of those assets was vital to the purchase, and the litigation necessary for valuation was thus inextricably woven into the fabric of the overall transaction. Petitioners have the burden of clearly showing their right to the claimed deduction. **Interstate Transit Lines v. Commissioner**, 319 U. S. 590, 593 (1943); **Iowa Southern**, *supra*, at 385. They failed to discharge that burden.

The decision of the Tax Court is affirmed.

JUDGMENT
of the
United States Court of Appeals
for the Eighth Circuit

No. 19,386

Fred W. Woodward and Elsie M. Woodward,
F. R. Woodward and M. Jeanne Woodward
Petitioners
v
Commissioner of Internal Revenue
Respondent

(May 2, 1969)

Before Matthes, Mehaffy and Lay, Circuit Judges

This cause came on to be heard on the petitions to review the decision of the Tax Court of the United States entered February 23, 1968, determining that there is a deficiency in the income taxes of the petitioners for the taxable year 1963, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the Decision of the Tax Court of the United States in this cause be, and the same is hereby, affirmed.

And it is further ordered by this Court that the Petition to review in this cause be, and the same is hereby, dismissed.

Order entered in accordance with opinion.

Robert C. Tucker,
Clerk.

Filed May 2, 1969

In the
Supreme Court of the United States
October Term, 1969

No. 412

Fred W. Woodward and Elsie M. Woodward,
F. R. Woodward and M. Jeanne Woodward
Petitioners

v

Commissioner of Internal Revenue
Respondent

**ORDER GRANTING CERTIORARI—
FILED OCTOBER 20, 1969**

The petition herein for a writ of certiorari to the United States Court of Appeals for the Eighth Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Filed October 20, 1969